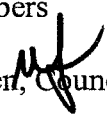


## MEMORANDUM

April 29, 2010

TO: Councilmembers

FROM: Nancy Floreen,  Council President

SUBJECT: **Office of Legislative Oversight Project on the Structural Budget Deficit**

Last month, I circulated a memo suggesting that the Council must begin the work of confronting the County's structural budget deficit. In March, the Executive had projected budget gaps of hundreds of millions of dollars in each of the next five years. As you are well aware, the County's fiscal situation has grown even more serious in the past few weeks.

My memo indicated that I planned to ask the Office of Legislative Oversight (OLO) to develop a recommended scope of work to address the following questions:

1. What are the assumptions behind the Executive's future year gap projections?
2. What are the major factors driving the projected budget deficits? Which of these factors represent fixed commitments?
3. What policy and budget options are available going forward to address the structural budget deficit?

In response to my request, Karen Orlansky prepared the attached memo proposing a scope of work for this project. Karen's memo discusses the timing and staffing of an OLO project as well as its relationship with other initiatives intended to address the County's ongoing fiscal challenges. **Please contact Karen directly if you have any questions or comments about the proposed scope of work.**

It is my goal is to have the Council add this project to OLO's Work Program in late May, concurrent with the Council's final action on the FY11 budget. I am asking for your support for this effort as an important component of the Council's work to address the County's future budget challenges.

Attachment: April 27, 2010 from OLO Director outlining a proposed scope of work

## MEMORANDUM

April 27, 2010

TO: Nancy Floreen, Council President

FROM: Karen Orlansky<sup>ko</sup>, Director  
Office of Legislative Oversight

SUBJECT: **OLO Project on Montgomery County's Structural Budget Deficit**

This memorandum proposes a scope of work for an Office of Legislative Oversight (OLO) project related to Montgomery County's structural budget deficit. It also addresses how this OLO project can and should be coordinated with other initiatives to address the County's fiscal challenges. I understand you would like the Council to formally add this project to OLO's Work Program in late May, concurrent with the Council's final action on the FY11 budget.

### **A. Purposes of an Office of Legislative Oversight Project**

Based on our initial conversations about this project, there are multiple purposes to an OLO study on the County's structural budget deficit:

- To provide the basis for an informed dialogue about the County's fiscal future.
- To define a structural budget deficit and differentiate it from an annual budget gap.
- To identify the assumptions used in developing the County Executive's "Fiscal Plan;" and to show how changes in revenue and expenditure assumptions change the size of the future structural budget deficit.
- To develop guiding principles and a range of policy/budget options for the Council to consider in order to balance projected revenues and expenditures over a long-term period.
- To recommend action items and a timetable for Council decisions.

### **B. Coordination with Related Initiatives**

Given the magnitude of the County's fiscal challenges, there is ample opportunity for multiple initiatives to examine the problem and offer potential solutions. It will be, however, incumbent upon those of us involved in the various, simultaneous endeavors to coordinate our work with the goal of avoiding duplicating one another's efforts. I would recommend that the principal staff involved across the different initiatives meet regularly so that we can all remain current with one another's progress and adjust our own work schedules and agendas accordingly.

As of this writing, I am aware of the following efforts that OLO would need to coordinate with throughout the study period. To the extent that the focus of the initiatives described below is to identify ways to reduce agency expenditures through resource-sharing and reorganization, this would free up OLO's time to study other options for reducing the structural budget deficit.

- ◆ **The Cross-Agency Resource-Sharing Committee (CARS).** On March 24<sup>th</sup>, the Chief Administrative Officer sent a memo to the principals of all County agencies and the County Council requesting their participation in a Cross-Agency Resource-Sharing Committee. The stated purpose of the Committee is to “develop common approaches to cost reduction, resource sharing, and improved operational efficiencies.” The CAO identified nine separate functional areas for the Committee to focus on: Information Technology; Utilities; Facilities Planning, Design, Construction, and Maintenance Procurement; Space Utilization; Fleet; Mailing, Printing, and Document Management; Employees and Retirees Benefit Plans (health, retirement, etc.); and Administrative Functions (payroll, budget, finance, training).

In addition to citing the Cross-Agency Resource-Sharing Committee, the County Executive's April 22, 2010 memo to the Council (transmitting his recommendation for adjustments to the FY10 and FY11 operating and capital budgets) states that he will “shortly provide the Council with a comprehensive list of options for additional organizational restructuring and cost saving proposals for review during FY11 and implementation in FY12.”

- ◆ **Councilmember Berliner's Proposal for a Commission to Restructure County Government.** On April 19<sup>th</sup>, Councilmember Berliner proposed that the County Executive and Council jointly appoint a 14-person Reform Commission. As stated in Mr. Berliner's memo to other Councilmembers, “[t]his Commission, composed of Montgomery County residents with experience and expertise in efficient service delivery systems, would be briefed by Executive Branch staff, Council staff, workforce representatives and other stakeholders on a range of restructuring options. The Commission would then forward its findings and recommendations to the County Executive and the Council by January 31, 2011.”

### **C. Recommended Approach and Scope of an Office of Legislative Oversight Project**

This section outlines my proposal for the substance and timing of an OLO project on the structural budget deficit. In developing the proposed scope of work for OLO, I relied upon the three central questions you highlighted in your March 15, 2010 memorandum to Councilmembers (attached):

1. What are the assumptions behind the Executive's future year gap projections?
2. What are the major factors driving the projected budget deficits? Which of these factors represent fixed commitments, e.g., debt service, pension obligations?
3. What policy and budget options are available going forward to address the structural budget deficit?

**I recommend the Council establish December 2010 as the target due date for this project.** I would organize OLO's report back to the Council into two parts as follows:

<b>Part</b>	<b>Topic</b>
I	The County's Structural Budget Deficit: Defined, Quantified, and Explained
II	Options to Achieve Long-Term Fiscal Balance

A further description of what OLO would accomplish in each of the two parts follows.

### **Part I: The County's Structural Budget Deficit: Defined, Quantified, and Explained**

The primary purpose of Part I would be to promote a full and fair understanding of the causes and size of Montgomery County's structural budget deficit. OLO's work on Part I will be divided into three tasks summarized below.

**A. Defining a Structural Budget Deficit.** OLO will begin its review by providing a working definition of a structural budget deficit (SBD). The report will explain the difference between a single year budget gap and an on-going, recurring imbalance of revenues and expenditures. In addition, OLO will describe the factors that contribute to the development of a structural imbalance between public sector revenues and expenditures.

**B. A Review of Past Decisions and Trends in Montgomery County.** Based on a review and analysis of data from the past ten years, OLO will present information on the major budgetary decisions, demographic changes, and economic trends that have combined to create the current picture of a recurring annual mismatch between revenues and expenditures. This analysis will identify:

- The annual rates of change in County revenues and expenditures over the last decade;
- Significant changes in the revenue structure, sources, and composition;
- Significant "macro-level" trends in County agency expenditures (the major "cost drivers");
- Major trends in local government service demands;
- Requirements in State and local law that affect revenues and expenditures (e.g., MOE law, Charter limit); and
- Growth in fixed expenditure obligations (e.g., debt, pension payments, OPEB obligations).

**C. Projecting the Future Growth of Revenues and Expenditures in Montgomery County.** OLO will conduct a critical assessment of the County's future year revenue and expenditure projections. OLO's work will include review of the assumptions and methodologies used in the Executive's most recent six-year Fiscal Plan, including projections of:

- Revenues generated from taxes, fees, and other sources during the next six years;
- County agency expenditures during the next six years;
- Changes in future year expenditure commitments;
- Changes in service demand (growth in population, MCPS enrollment, etc.); and
- Future year legal and other fixed obligations.

OLO's report to the Council will include examples to illustrate how changing key assumptions behind the six-year projections alter the size of the future years' gaps between revenues and expenditures.

## **Part II: Options to Achieve Long-Term Fiscal Balance**

Based on the findings of Part I as well as research into strategies being implemented in other jurisdictions, OLO will present the Council with options to achieve a long-term projection of balanced revenues and expenditures. This analysis will be comprised of the following three tasks.

**A. Guiding Principles.** OLO will develop a set of guiding principles for Council consideration that would help shape future fiscal planning and budgetary decision-making. For example, these guiding principles could include policies that address:

- The use of projected future year revenue projections and economic indicators (e.g., inflation rate) in determining future expenditure levels;
- Measures to control future year expenditure obligations (including debt service, pension obligations, and other post-employment benefits);
- Fund reserve levels;
- The use of one-time resources;
- Cost recovery for fee-supported programs and services; and
- Capital programming of new facilities that will have future operating budget impacts.

**B. Revenue Options.** This task will involve researching, identifying advantages and disadvantages, and pricing different methods of increasing future year revenues. Options would include adjustments to tax and fee rates and imposition of new taxes and fees. OLO will estimate the amount of revenues that could be generated by the different options as well as the burden the options would place on ratepayers.

**C. Expenditure Options.** The purpose of this task is to generate options for containing future personnel and operating expenditures. Because personnel costs represent the largest portion of agency costs, OLO will focus on options for reducing the size of the workforce and controlling per employee compensation cost increases. In selecting the specific options to study and present to the Council, OLO will:

- Focus on ways to address the cost drivers identified in Part I;
- Apply lessons learned from other jurisdictions that are grappling with resolving their own structural budget deficits; and
- Place priority on strategies that have significant and ongoing fiscal impact.

As discussed earlier in this memo, it will be especially important that OLO's work on identifying expenditure options be coordinated with related Council and Executive-sponsored efforts.

#### **D. Staffing**

I am confident that the in-house OLO staff team can accomplish the bulk of this assignment within the above-referenced deadlines. However, there are several caveats to this statement. First, OLO staff will need to consult regularly with the experts on the Council's staff, including the Legislative Attorneys on legal issues and the Council's actuary (under contract) for certain cost projections. Outside of the Legislative Branch, OLO would conduct its work in close cooperation with Executive Branch staff (especially staff in CountyStat, Office of Management and Budget, Department of Finance, and Office of Human Resources), as well as their counterparts in the other County-funded agencies.

Second, if the Council assigns this ambitious project to OLO, then it will consume almost all of OLO's staff resources during the first half of FY11. In other words, few (if any) other new projects could be undertaken by the office until January 2011. This timing would allow for the newly elected Council to determine OLO's Work Program for the second half of FY11.

I look forward to receiving feedback on the ideas presented in this memo, and to integrating suggestions for how OLO's work on the structural budget deficit can be shaped to maximize its relevance and usefulness to the Council moving forward.

Attachment: March 15, 2010 memo from Council President Floreen to County Council

cc: Steve Farber, Council Staff Director




MONTGOMERY COUNTY COUNCIL  
ROCKVILLE, MARYLAND

OFFICE OF THE COUNCIL PRESIDENT

MEMORANDUM

March 15, 2010

TO: Councilmembers  
FROM: Nancy Floreen,  Council President  
SUBJECT: Assessment of Montgomery County's Structural Budget Deficit

As you know, a structural budget deficit exists when ongoing expenditures consistently exceed ongoing revenues, even in periods of relative prosperity. The deficits that governments face today are not only cyclical – the result of the worst recession since the Great Depression – but structural as well. The federal government and many state and local governments, including the State of Maryland and Montgomery County, now confront deficits of both kinds. Many of us have raised this issue.

The County Executive's recommended FY11 operating budget and FY11-16 Fiscal Plan confirm this point. To close a gap most recently projected at \$779 million, equal to about one-fifth of the approved aggregate operating budget for FY10, the Executive has proposed service reductions, position abolishments, furloughs, and departures from County fiscal policies on a scale that we have never seen before. But the FY11-16 Fiscal Plan shows that even after such actions to achieve a balanced budget in FY11 have been taken, large gaps in future years will persist – including FY12, when federal stimulus dollars will run out. The gaps projected for FY12-16, respectively, are currently estimated to exceed \$212, \$303, \$417, \$464, and \$514 million.

Besides resolving the acute FY11 budget challenge that is now before us, we need to address the chronic budget challenges that lie ahead. I believe that we must address at least three central questions:

1. What are the assumptions behind the Executive's future year gap projections?
2. What are the cost drivers associated with the structural deficit in future years?
3. What policy and budget options are available going forward to address the structural deficit?

To start this process, I will ask the Office of Legislative Oversight to develop a recommended scope of work to answer these three questions. With regard to timetable, I suggest that the Council formally approve a project assignment to OLO at the time we approve the FY11 budget in late May, and that the project be completed by early December, when the new Council will take office. I believe that this project has the potential to produce not only useful information but real results.

As we move forward, answering these questions will require the Council to consult with the Executive and the leadership of MCPS, the College, and Park and Planning, as well as our employee organizations and community stakeholders. Please get back to me by the end of the week with your thoughts and suggestions on this proposal.